

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Oller Analyst: Norm Catelli Bill Number: SB 1602  
Related Bills: \_\_\_\_\_ Telephone: 845-5117 Introduced Date: 2/20/2002  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Nonconformity to Federal Theft Loss Deduction

### SUMMARY

This bill would modify the rules relating to a theft loss deduction to give a taxpayer the option to deduct the loss in the year when the theft took place, if the thief was convicted of committing the crime.

### PURPOSE OF THE BILL

According to the author's office, the purpose of the bill is to aid taxpayers that are fraudulently induced into selling property and deprived of the proceeds. This bill will aid taxpayers that are victims of fraud because they may be subject to taxable income from the fraudulent transaction in the year the property was sold but under circumstances where the fraud is not discovered until a later year.

### EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and would be operative for taxable years beginning on or after January 1, 2002.

### POSITION

Pending.

### ANALYSIS

#### FEDERAL/STATE LAW

Pursuant to Internal Revenue Code (IRC) Section 165, casualty and theft losses of non-business property are deductible subject to a \$100 floor per casualty or theft and an overall floor of 10% of adjusted gross income for losses exceeding casualty gains. Casualty is damage or loss of property from an identifiable event that is sudden, unexpected, or unusual. Theft is unlawful taking and removing of money or property with intent to deprive the owner of it.

California generally conforms to IRC Section 165, which allows, with some limitations, a deduction for a loss sustained during the taxable year that is not reimbursed by insurance or some other kind of compensation. The loss must be evidenced by closed and completed transactions, fixed by identifiable events, and actually sustained during the taxable year. Theft losses are treated as sustained during the taxable year in which the taxpayer discovers the loss.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Alan Hunter for GHG

03/27/02

## THIS BILL

This bill would give certain taxpayers a new option-- to deduct theft losses in the year of the theft, even if the theft is not discovered until a subsequent year, if the thief is convicted of the crime. This option is in addition to current law which limits the deduction to the year the theft is discovered.

## IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

## TECHNICAL CONSIDERATIONS

This bill uses the word "sustained" to mean the taxable year when the theft occurred. Current federal and state laws define "sustained" (IRC 165(e)) to mean the year in which the theft was discovered. To avoid confusion, the author might want to consider amending the bill to correctly reflect the intent for this bill.

## **OTHER STATES' INFORMATION**

*New York, Michigan, and Minnesota* conform to the federal casualty loss provisions. *Illinois* begins its tax base computation with federal adjusted gross income and does not allow itemized deductions, which precludes any casualty or theft loss deduction. *Massachusetts* allows some federal itemized deductions, but not a casualty or theft loss deduction.

## **FISCAL IMPACT**

This bill would not significantly impact the department's costs.

## **ECONOMIC IMPACT**

### Revenue Estimate

This proposal is expected to result in minor revenue losses annually (less than \$500,000).

### Revenue Discussion

This proposal affects only those taxpayers that sustained a theft loss in a prior year without their knowledge and have not or will not be compensated for their loss by insurance or otherwise. Further, the revenue loss is dependent on how many of these taxpayers will wait for a conviction and choose to amend their income tax returns (if necessary) to report the loss in the year sustained. Essentially, this proposal represents a timing issue; however, there are potential revenue losses if a taxpayer did not have income to offset the loss in the year the loss was discovered but did have income in the year the theft occurred.

Data available indicates that for tax year 1999 approximately 14,000 taxpayers reported casualty and theft losses that totaled \$160.2 million. Information indicating what portion of this is due to theft losses is not available. However, due to the various natural disasters that occur in California each year (i.e. fire and flood), it is reasonable to assume the amount of casualty and theft losses reported are mainly due to casualty/disaster losses. The portion of taxpayers that report theft losses must further be reduced by those taxpayers that would only qualify to report the loss under current law conditions. The resulting number of taxpayers that would qualify under this bill to report losses in the year sustained is not expected to be significant.

## **ARGUMENTS/POLICY CONCERNS**

The concept that a loss must be evidenced by a “closed and completed transaction” has its origin in early case law. (See e.g. *United States v. White Dental Co.* (1927) 274 U.S. 398.) Though subject to judicial interpretation, the concept generally means that the theft has been discovered and it is unlikely that the loss will be compensated. That concept became the basis for the numerous statutory requirements that deductible losses must be a “closed and completed transaction.” A policy question may be raised about the need to create a statutory exception to what appears to be a well established legal precept.

A problem may arise with the interaction of the current statute of limitations (SOL) for refunds and the bill’s requirement that there be a conviction. The length of time required to discover the theft and secure a conviction may exceed the SOL for a claim for refund in all but the most serendipitous cases. The current SOL for a claim for refund is four years from the date of the timely filing of the return for the taxable year.

The bill should address how the provisions of the bill would be impacted by a successful appeal of an underlying criminal conviction.

There may be a question of equity between a taxpayer that is a victim but the perpetrator is not convicted contrasted with victims where the perpetrator is convicted.

## **LEGISLATIVE STAFF CONTACT**

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